In the Supreme Court of the United States

OCTOBER TERM, 1925

No. 864

THE UNITED STATES, APPELLANT

v.

THE PITTSBURGH & WEST VIRGINIA RAILWAY COMPANY and the West Side Belt Railroad Company

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No. 865

THE PITTSBURGH & WEST VIRGINIA RAILWAY COMPANY and the West Side Belt Railroad Company, Appellants

v.

THE UNITED STATES

APPEALS FROM THE COURT OF CLAIMS

REPLY BRIEF FOR THE UNITED STATES

Two matters dealt with in the brief for the railway companies are commented on in this reply. The first is whether there is justification for our

assertion that the railway companies in this case gained in the matter of taxes by the delay in fixing and paying their compensation, and the second relates to administrative interpretations by the Treasury Department.

I

In the main brief for the United States it was stated (pp. 29–30) that the record justified the inference that the appellees are better off in the matter of taxes by having the compensation treated as income for the year 1921 than they would have been if the compensation had been fixed and paid during Federal control and subjected to income taxes assessed for that period, for part of which they would have been reimbursed by the Director General. The appellees in their brief (pp. 20–21) characterize this as a wild assumption, without any basis.

Further examination of the record discloses that the United States did not go far enough in its main brief, and that there is ample basis in the record for a mathematical demonstration that the appellees have gained in the matter of taxes by delay in the determination and payment of their compensation, even if the United States is not required to pay any part of the income tax for the year 1921. This point was not urged by the United States as a reason for departing from the terms of the contracts and statutes defining its lia-

bility for taxes, but to support the view that there is no reason for avoiding the plain terms of the contract and statute, because of the claim of the appellees, insisted on from the beginning (p. 8) to the end (p. 31) that they are "discriminated against and penalized" as a result of the position taken by the United States in this case.

We will show the result in taxes, if the compensation paid in 1921 had been fixed and paid during Federal control.

The findings of fact show that, after crediting to gross income for the year 1921, the sum of $1,570,000 paid by the United States in that year (R. 13), and after deducting from gross income all the deductions allowable for that year, the net taxable income of these corporations for the year 1921 was $1,064,781.39. This was less than the compensation included in gross income for that year, and if the compensation paid in 1921 is to be treated as earned or paid during the period of Federal control, there would have been no income tax on these corporations for 1921, so taking the compensation from the income for that year results, to start with, in a tax saving to the appellees of $106,478.13, the amount of the 1921 tax.

Turning to the situation disclosed by the findings with respect to the years 1918, 1919, and 1920, we find that in each of those years, whether or not any part of the compensation was included in

gross income, and after allowing all deductions and credits allowable by law for those years, there was a net taxable income for each of those years (R. 13, 14). It follows that if any part of the compensation paid in 1921 is to be included in gross income for any year during the period of Federal control, there will be an increase in the net taxable income of each of these years equal to the amount of the compensation included in the gross income. The only remaining factor in the calculation is to determine to what year or years of the period of Federal control the compensation should be allocated in determining the taxable income of these corporations. There are two methods open, one being to proceed on the theory that the corporation kept its accounts on an accrual basis and to treat the compensation as accrued in each year at the monthly rate ultimately fixed by the settlement agreement. This was the method which the Bureau of Internal Revenue first insisted on. The other available method would be to consider the returns of the appellees as made on a cash receipts and disbursements basis and allocate the compensation to the year in which it would have been paid if the agreement fixing it had been made in advance.

Proceeding first on the accrual basis, the aggregate compensation agreed on was $1,820,000 for the 26 months of Federal control, which is at the rate of $70,000 per month. On the accrual basis,

twelve twenty-sixths of that amount, or $840,000, would be assigned to gross income for 1918, a like amount, $840,000, to 1919, and two twenty-sixths, or $140,000, assigned to the first two months of 1920.

In 1918 the rate was 12%, of which the Director General would have reimbursed the carrier for one-sixth, and the share of the 1918 tax to be borne by the carriers would have been 10% of the net income; and if $840,000 is added to the net taxable income for 1918, the additional tax for that year to be borne by the carrier, after the Director General had paid his share, would have been $84,000.

In the year 1919 the rate was 10%, and the share to be borne by the carrier was 8% of its net income, and if $840,000 be added to the net income for 1919, 8% of that amount would represent an additional tax of $67,200 to be borne by the carrier over and above the share borne by the Director General.

For the year 1920, $250,000 paid in that year as compensation was included. On the accrual basis, only $140,000 should have been included. Consequently, $110,000 too much was included, on the accrual basis, in the 1920 gross income. The 1920 rate was 10%, and the reduction in the carriers' share of the tax by reducing in the sum of $110,000, the net income for that year, would have been 8% thereof, or $8,800. In addition, the carrier would have saved five-sixths of the additional 2%, which

would be $1,833. Tabulating this, the following result is disclosed:

Additional tax for 1918	$84,000.00	
Additional tax for 1919	67,200.00	
		$151,200.00
Total	151,200.00	
Reduction in tax for 1921	106,478.14	
Reduction in tax for 1920	10,633.00	
		117,111.14
Total	117,111.14	
Net gain		34,088.86

The appellees discuss the matter on a cash receipts and disbursements basis, and say that it does not appear what part of the agreed compensation was for the year 1918, the year in which the high rate of 12% was imposed. For the purposes of the calculation, we will yield to these points and treat the $1,570,000 of compensation paid in 1921 as having all been paid in 1919, and no part as having been paid in 1918, the year in which the high rate existed.

As the findings show that after taking all allowable deductions for 1919, these carriers still had a net taxable income (R. 13), the addition of $1,570,000 to the cash receipts for 1919 and to the gross income for 1919 results in an increase in the same amount in the net taxable income for that year. Of the 10% tax for that year, 8% of the net income would represent the share to be borne by the carriers and 8% of $1,570,000 is $125,600, which would have been an increase for the tax in 1919 over and above the share to have been borne by the Director General.

On a receipts and disbursements basis, the $250,000 paid on account in 1920 is left where it is.

While there would have been an increase in the carriers' share of the taxes for 1919, in the sum of $125,600, if the compensation paid in 1921 had been paid in 1919, there would also have been a saving to the carriers of $106,478.14, through a reduction of the 1921 tax, by excluding the compensation from gross income for that year. The difference between these two amounts is $19,121.86.

If, in making the calculation on the accrual basis, all of the compensation be treated as accrued in 1919 and 1920, the low rate years, the saving disclosed would have been the same, to wit, $19,121.86.

It has therefore been demonstrated, from calculations based on facts disclosed by the findings, that if the compensation in this case had been fixed and agreed upon promptly at the beginning of Federal control, and the compensation paid during Federal control, or considered as accrued during Federal control (depending upon the method used by the carrier in its accounting system and as a basis for its returns), and although the Director General being obliged to pay the 2% tax assessed for the period of Federal control would thus have borne a share of the tax on the compensation included in the computations of net taxable income for the period of Federal control, nevertheless on the accrual basis the carrier would have

been worse off to the extent of $34,088.86 in the matter of taxes, and on a cash receipts and disbursements basis worse off to the extent of $19,121.86 in the matter of taxes, than it is as a result of the delay and the payment of part of the compensation in 1921, and with the result that the Director General is not required to pay any share of the income tax for 1921 on the income in which the compensation paid in that year is included. It will be noted that in the calculation on the cash basis, we have resolved every doubt in favor of the appellees and treated the compensation as paid in the year in which the lowest tax rate was applicable.

In the face of these figures, the appellees are hardly justified in characterizing our statements as wild assumptions or in making claims that it has been "discriminated against and penalized to the extent of having its compensation diminished."

On page 19 of the appellees' brief is the statement that, in so far as the record shows, every railroad in the country, except the appellees, received its compensation undiminished by the imposition of the two per cent normal tax.

What does appear in the record contradicts this statement. The record shows that the Director General has in the case of all railroads adhered consistently to the view that the only income taxes of which he is required to pay a share, are those

assessed for the period of Federal control. (R. 12–14.) Any carrier, any part of whose compensation has been paid since Federal control, is in the same position as these appellees. It will hardly do to assume that the compensation of all carriers, except appellees, was fixed and paid during Federal control. The reports of the Director General show that over $100,000,000 of compensation has been paid since Federal control ended. The claim of " discrimination " is a bald assertion, with nothing to support it. This case only involves $21,295.00. If no others were to be ruled by it we would not be troubling this Court with it.

II

The appellees claim that the practical construction by the Treasury Department and the Railroad Administration has been against the contention of the United States.

The practical construction by the Railroad Administration has already been dealt with in the main brief, in which it has been demonstrated that the share of the tax for 1918, 1919, and 1920 to be borne by the Railroad Administration has been adjusted, agreed on and fixed between these carriers and the Director General on the very basis on which the United States now stands—that is to say, on the basis that the Director General was liable for a share of the income tax assessed for the period of Federal control without regard to

the source from which the income was received and without regard to whether compensation was included, thus rejecting the theory that the Director General is to bear a tax assessed for some year not included in Federal control, merely because of the source of the income. The findings also show that the Director General construed the law as imposing the entire tax liability on the carriers, and that his obligation was merely to reimburse them for a share of it.

The administrative interpretation by the Treasury Department on these two points disclosed by the appellees' brief is just the contrary of that asserted by the appellees and exactly consistent with the position of the United States. We are grateful to the appellees for printing in the appendix to their brief (on pp. 33–37) the letter from the Commissioner of Internal Revenue to the appellees' counsel relating to this very case and dated July 14, 1922. That letter shows beyond a doubt that the Commissioner of Internal Revenue took exactly the position here taken by the United States in holding that the liability of the Director General was for a share of the tax for the period of Federal control "on income from all sources, whether or not derived from railway operations." (Page 35, appellees' brief.) The Commissioner also declared, in express terms, that the full tax was imposed upon the carrier by law and that "any payment, therefore, of part of the tax by the

Railroad Administration is in satisfaction of an obligation or liability of the carrier. If the Railroad Administration after the expiration of Federal control, no longer pays part of that obligation imposed upon the railroads by Section 230 (a) of the Revenue Act of 1918, the railroads themselves are necessarily liable." (Pages 36 and 37, appellees' brief.)

The second letter from the Commissioner, dated September 8, 1922, at page 37 of the appellees' brief, merely discloses what we stated in the brief for the United States, that the Bureau of Internal Revenue yielded to the claim of these appellees that the compensation paid in 1921 should not be considered as an accrued earning during the period of Federal control because the amount was then too uncertain to be so considered.

Both the Railroad Administration and the Bureau of Internal Revenue have therefore consistently adhered to the view that the share of the income taxes to be borne by the Railroad Administration was a share of taxes assessed for the period of Federal control without regard to the source of the income and not a tax assessed for some other period than that of Federal control even though compensation was included in the income, and both Departments have consistently adhered to the view that the full tax was by law levied upon the carriers, and that such obligation as the Director General assumed by contract was an obligation to

reimburse the carrier or discharge a part of the carrier's liability to the United States.

Respectfully submitted.

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Solicitor General.

A. A. MCLAUGHLIN,
General Solicitor, United States Railroad Administration.

MARCH, 1926.

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In the

Supreme Court of the United States

October Term, 1925

No. 364

THE UNITED STATES, *Appellant*

v.

THE PITTSBURGH & WEST VIRGINIA RAILWAY COMPANY AND THE WEST SIDE BELT RAILROAD COMPANY

No. [illegible]

THE PITTSBURGH & [illegible] VIRGINIA RAILWAY COMPANY AND THE WEST SIDE BELT RAILROAD COMPANY, *Appellants*

v.

THE UNITED STATES

APPEALS FROM THE COURT OF CLAIMS

BRIEF FOR APPELLEES AND CROSS-APPELLANTS

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THE UNITED STATES

APPEALS FROM THE COURT OF CLAIMS

BRIEF FOR APPELLEES AND CROSS-APPELLANTS

STATEMENT

This is a suit to recover the two per cent corporation income tax levied by the Revenue Act of 1916, (39 Stats. 756), upon and payable, ordinarily, out of

corporation net income; but, with reference to railroad corporations, and for the period of Federal control, levied upon and payable from "the revenues derived from railway operation." (Section 1 Federal Control Act, 40 Stats. 451).

Appellees and cross-appellants (hereinafter called appellees) are the Pittsburgh & West Virginia Railway Company and the West Side Belt Railroad Company. All of the capital stock of the latter company is owned by the former, and for purposes of taxation the two companies were required to file consolidated tax returns. (R. 11). The railway properties of appellees were taken over by the Government for the period of Federal control of railroads.

Section 10, Par. (a) of the Act of Sept. 8, 1916 (39 Stat. L. 756) provided,—

> "That there shall be levied, assessed, collected, and paid annually upon the total net income received in the preceding calendar year from all sources by every corporation, * * * a tax of two per centum upon such income."

Section 4, par. (a) of the Revenue Act of 1917, approved October 3, 1917 (40 Stats. 300) provided,—

> "That in addition to the tax imposed by subdivision (a) of section ten of such Act of September eighth, nineteen hundred and sixteen, as amended by this Act, there shall be levied, assessed, collected, and paid a like tax of four per centum upon the income received in the calendar year nineteen hundred and seventeen and every calendar year thereafter, by every corporation."

The Act of Sept. 8, 1916, was passed before the United States entered the war and the two per cent

tax thereby imposed is hereinafter referred to as the "normal two per cent tax." Beginning with the war period and by the Revenue Act of 1917, an additional tax of four per cent was imposed, and this additional four per cent tax was known as a "war" tax.

Section 1 of the Act of March 21, 1918, (The Federal Control Act; 40 Stats. 451) among other things, provided,—

> "Any Federal taxes under the Act of October 3, 1917, or Acts in addition thereto or in amendment thereof, commonly called war taxes, assessed for the period of Federal control beginning January 1, 1918, or any part of such period, shall be paid by the carrier out of its own funds, or shall be charged against or deducted from the just compensation;"

and

> "That other taxes assessed under Federal or any other governmental authority for the period of Federal control or any part thereof, either on the property used under such Federal control or on the right to operate as a carrier, or on the revenues or any part thereof derived from operation * * * shall be paid out of the revenues derived from railway operations while under Federal control * * *."

The Federal control Act treats the additional four per cent tax imposed by the Revenue Act of 1917 as a "war" tax.

The Revenue Act of 1918 (40 Stats. 1057), approved on February 24, 1919, after the passage of the Federal Control Act provided in section 230, par. (a),—

> "That, in lieu of the taxes imposed by Section 10 of the Revenue Act of 1916, as amended by the

> Revenue Act of 1917, and by Section 4 of the Revenue Act of 1917, there shall be levied, collected and paid for each taxable year upon the net income of every Corporation a tax at the following rates:
>
> (1) For the calendar year 1918, 12 per centum of the amount of the net income in excess of the credits provided in Section 236; and (2) for each calendar year thereafter, 10 per centum of such excess amount."

Section 230, par. (b) of the same Act provided that,—

> "For the purposes of the Act approved March 21, 1918, entitled 'An Act to provide for the operation of transportation systems while under Federal control, for the just compensation of their owners, and for other purposes,' five-sixths of the tax imposed by paragraph (1) of subdivision (a) and four-fifths of the tax imposed by paragraph (2) of subdivision (a) shall be treated as levied by an act in amendment of Title I of the revenue act of 1917."

Railroad properties were taken over for the period of the war emergency as completely as though by purchase. Under Section 12 of the Act *all revenues derived from operation belonged solely to the Government* and all that was left to the railroad corporations was the provision for just compensation as defined by the Act. Section 1 of the Act provided that for carriers operating normally just compensation should be based upon the average net earnings for the three years immediately preceding Federal control; but that for carriers whose average net earnings (because of re-organizations or other

abnormal conditions) were not fully reflected in the net income, the Director General should enter into negotiation in order to establish such just compensation. Appellees came within the latter class and were forced to negotiate with the Director General to determine just compensation. (R. 11, 12.) The carriers whose just compensation was readily determinable under the Act (and this class constituted practically all of the railroads under Federal control) entered into so-called standard contracts with the Government and received their compensation in installments three or four times a year, while their properties were held by the Government.

The Government concedes that the two per cent normal tax here involved was assumed or paid by it for all railroads thus promptly receiving their just compensation, while Federal control existed, and the Court below so found. (Finding IV, R. 12.) It was the custom, however, for each carrier to return and pay the said two per cent normal tax, together with the taxes payable out of its own funds, whereupon the Government duly credited the carrier for such payment.

All carriers promptly receiving their just compensation during Federal control thus received credit for the two per cent normal tax and the same was borne or paid by the Government. (R. 12.)

The period of Federal control extended from January 1, 1918, to February 29, 1920. (R. 11.) From the beginning to the end of this period, appellees were negotiating with the Director General but no amount of just compensation could be arrived at. The Director General insisted that because of "over-maintenance, betterments and improvements" made by him on appellees' property, that appellees not only were not en-

titled to any compensation whatsoever for the use of the properties, but the Government was entitled to be paid for such over-maintenance, betterments and improvements. Federal control terminated on February 29, 1920, but the controversy between the Director General and appellees continued until *July 1, 1921,* at which time a settlement was effected (R. 5, 9), although in January, 1920, the Director General had made a payment to appellees of $250,000 "on account." (R. 12.)

On July 1, 1921, appellees received, in addition to the $250,000 paid in 1920, the sum of $1,570,000 in full settlement of their just compensation for the use of their properties during Federal control (R. 12), but at that time appellees were no longer under Federal control, and there was no way in which the normal two per cent tax, if returned and paid by appellees, could be credited to them by the Government. (R. 13.) In this situation, appellees applied to the Commissioner of Internal Revenue for a ruling as to the rate of tax to be paid, claiming that it should be credited for the normal two per cent tax payable under the law by the Government. The Commissioner ruled, in his decision of July 14, 1922, that,

> "It was the intention of Congress that this 2% tax which was not regarded as a war tax should be paid by the Railway Administration," and

that the Director General, in the contracts,

> "obligated himself to account for all Federal income taxes for which the railroad companies were not made responsible by specific provision of law in amendment of the Revenue Act of 1917, * * *."

The Commissioner furthermore held, however, that,

> "If the Railroad Administration, after the expiration of Federal control, no longer pays part of that obligation imposed upon the railroads by Section 230 (a) of the Revenue Act of 1918, the railroads themselves are necessarily liable."
>
> (The full text of the ruling is quoted in the appendix to this brief.)

Thereupon appellees paid the full tax under protest.

Under the settlement agreement of July 1, 1921, providing for appellees' just compensation, the Government agreed either to "pay out of revenues derived from railways' operation during the period of Federal control, or save the company harmless" from all taxes, except "war" taxes, assessed under any Federal or other governmental authority for any part of the period of Federal control on the property under such control, *"or on the revenues derived from operation" of the same.* (R. 9.) Subsequent to the ruling by the Commissioner, taxpayer called upon the Director General to reimburse it for the two per cent normal tax, but the Government has refused to reimburse it or to save it harmless from the payment of said two per cent tax. (R. 15.)

Appellees were required to pay, in addition to their "war" taxes, the two per cent normal tax upon income received from operations under Federal control, although they did not receive the "revenues derived from railway operations." The tax was paid under protest, and a claim for refund filed and denied. Suit was then instituted and the Court below gave judgment for the full amount erroneously collected, from which judgment the Government appealed. (R. 16, 22.)

The cross-appeal involves the failure of the Court below to give judgment for the expense of the suit under the provision in the settlement agreement whereby the Director General of Railroads agreed to pay or save appellees harmless from the expense of all suits "respecting the classes of taxes payable by him." (R. 9.)

THE QUESTION INVOLVED

The only question involved is whether Congress intended that the just compensation of all carriers should be computed upon the same basis; or whether because a carrier without its fault is deprived of its just compensation for a period of time extending beyond the duration of Federal Control, the law intended that it should be discriminated against and penalized to the extent of having its compensation diminished by the payment of a tax which the Government uniformly assumed or paid for all carriers *promptly* receiving their just compensation?

SUMMARY OF ARGUMENT

I. THE FEDERAL CONTROL AND REVENUE ACTS IMPOSED UPON THE GOVERNMENT THE OBLIGATION TO ASSUME OR PAY THE NORMAL TWO PER CENT TAX UPON THE JUST COMPENSATION OF RAILROADS UNDER FEDERAL CONTROL.

II. *THE GOVERNMENT'S CONTENTION.*

III. THE DIRECTOR GENERAL OF RAILROADS IN FINAL SETTLEMENT WITH APPELLEES EXPRESSLY AGREED TO PAY THE NORMAL TWO PER CENT TAX.

IV. UNIFORM ADMINISTRATIVE INTERPRETATION BY THE TREASURY DEPARTMENT AND THE RAILROAD ADMINISTRATION IS THAT THE LAW IMPOSED THE NORMAL TWO PER CENT TAX UPON THE GOVERNMENT.

V. THE CROSS-APPEAL. APPELLEES ARE ENTITLED TO RECOVER THE EXPENSE OF THE LITIGATION.

ARGUMENT

I.

THE FEDERAL CONTROL AND REVENUE ACTS IMPOSED UPON THE GOVERNMENT THE OBLIGATION TO ASSUME OR PAY THE NORMAL TWO PER CENT TAX UPON THE JUST COMPENSATION OF RAILROADS UNDER FEDERAL CONTROL.

"In taking over and operating the railroad systems of the country the United States did so in its sovereign capacity as a war measure, 'under a right in the nature of eminent domain.'" (Dupont v. Davis, 264 U. S. 456, 462.)

The Federal Control Act declares the absolute ownership in the Government of all income and revenue derived from the operation of the railroads. (Section 12.) At the time of the passage of this act, the Revenue Act of 1916 had imposed a two per cent normal tax upon such revenue or income and the Revenue Act of 1917 had imposed an additional four per cent "war" tax upon such income.

The taking over of the railroads "under a right in the nature of eminent domain," involved, under the

Constitution, the duty to make "just compensation"; and in an endeavor to meet this constitutional obligation, Congress recognized that prior to the war, railway tax accruals and tax payments had been accounted for and paid from operating revenues, and the normal two percent tax was one of the taxes required under the accounting rules of the Interstate Commerce Commission to be included in the account known as "Railway Tax Accruals." All of the taxes authorized to be paid had been thus deducted from gross operating income during the years preceding Federal control before arriving at net operating income, and if the just compensation was to be on the basis of the net operating income, as provided in the Federal Control Act, it was proper and right for the Government to assume or pay taxes that had theretofore been deducted from gross operating income.

In providing a basis for just compensation, therefore, Congress wisely enacted in section 1 of the Federal Control Act, that every such compensation agreement shall provide that,—

> "Any Federal taxes under the Act of October 3, 1917, or Acts in addition thereto or in amendment thereof, commonly called war taxes, assessed for the period of Federal control beginning January 1, 1918, or any part of such period, shall be paid by the carrier out of its own funds, or shall be charged against or deducted from the just compensation";
>
> and
>
> "That other taxes assessed under Federal or any other governmental authority for the period of Federal control or any part thereof, either on

> the property used under such Federal control or on the right to operate as a carrier, OR ON THE REVENUES OR ANY PART THEREOF DERIVED FROM OPERATION * * * shall be paid out of the revenues derived from railway operations while under Federal control * * *." (Italics ours.)

The language used plainly enacts that the carriers must pay from their just compensation or other funds their share of the war cost,—"war taxes,"—taxes that theretofore had not been deducted from gross operating revenues in arriving at net operating revenues; but that all taxes other than war taxes, whether upon the physical property, the right to operate as a carrier, "or on the revenues derived from operation," the Government should assume or pay out of the revenues received from operation. The only tax here involved is the two per cent normal tax, because that is the only tax these appellees have been unlawfully compelled to pay, the Director General having assumed and paid all other taxes required by the Act.

Should all other argument fail as to the Government's obligation to pay this two per cent normal tax upon appellees' just compensation, there yet remains the undeniable evidence of the Legislative intent found in the use of the words that this normal two per cent tax should "*be paid out of the revenues derived from railway operations while under Federal control.*" The Act had previously declared the absolute ownership of the Government of all revenues derived from operations. If, therefore, the tax was to be paid out of such operating revenues, it necessarily follows that Congress placed the obligation solely upon the Government.

There is no doubt as to the intent of Congress, it is respectfully insisted; but that the view of the legislation above outlined be further confirmed, Committee Reports are quoted:

> "Ordinary taxes, federal and state, are to be paid as heretofore out of operating income. But war taxes are (in effect) payable out of the standard return; the owners of the railroad securities, like the owners of other securities, are thus left to carry their share of the war-tax burden." (House Interstate and Foreign Commerce Committee, reporting Federal Control Act to House on January 9, 1918.)

> "Section 1 further provides that ordinary taxes, national and state, shall, as now, be paid out of operating revenue; but war taxes, accruing under the act of October 3, 1917, are to be paid by the companies out of their own funds, or charged against the standard return." (Senate Committee on Interstate Commerce, reporting Federal Control Act to Senate on February 7, 1918.)

As if to further emphasize the correctness of this contention, Congress, subsequent to the passage of the Federal Control Act and in the Revenue Act of 1918, approved February 24, 1919, provided in section 230 (a), that in lieu of the taxes imposed by section 10 of the Revenue Act of 1916, as amended by the Revenue Act of 1917, there should be levied upon the net income of every corporation a tax of twelve per cent for 1918 and a tax of ten per cent for every year thereafter, *but that,*

> "For the purposes of the act approved March 21, 1918, entitled 'An Act to provide for the opera-

tion of transportation systems while under Federal control, for the just compensation of their owners, and for other purposes,' five-sixths of the tax imposed by paragraph (1) of subdivision (a) and four-fifths of the tax imposed by paragraph (2) of subdivision (a) *shall be treated as levied* by an act in amendment of Title I of the Revenue Act of 1917." (Italics ours.)

The Revenue Act of 1916 *levied* a normal tax of two per cent upon *the total net income* of every corporation.

The Revenue Act of 1917 *levied* an additional "war" tax upon *the total net income* of every corporation.

The Federal Control Act, in an endeavor to arrive at *just compensation* for the use of private property provided that all taxes upon *revenues derived from operation*, other than war taxes, should be paid out of such revenues, and such revenues belonged solely and alone to the Government; and,

The Revenue Act of 1918, while increasing the tax upon *net income* to twelve and ten per cent *levied* only five-sixths and four-fifths, respectively, of such taxes *as war taxes payable by appellees*, inferentially, at least, *levying* the remaining normal tax of two per cent upon the Government or upon operating revenues belonging solely to the Government.

In this situation it would seem unnecessary to urge that no matter when the just compensation, the net income, from its properties was received, appellees were not under the law subject to the normal two per cent tax upon such net income or just compensation received from its properties for the period of Federal control, because, whereas both the Revenue Acts of 1916 and 1917 had *levied* such a tax against appellees' net income, the Federal Control Act and Revenue Act

of 1918 had operated to repeal such levies! The Revenue Act of 1918 in terms *levied* a tax upon appellees *not including the normal two per cent tax but specifically excepting such normal tax from that imposed.*

The power to tax implies the power to destroy, and unless a tax be plainly imposed, it must not by construction or inference be enforced, and while there is no doubt, if doubt arises, it must be resolved as against the intent to tax.

It is submitted that the clear intent of Congress was that the Government should assume and pay the two per cent normal tax upon the net income received from railway operations during Federal control and that in no event should the just compensation to appellees, based upon such net income, be diminished by the imposition or collection of such a tax no matter at what period of time such compensation was received,—whether in 1919 or in 1921.

As was so forcibly stated in the opinion below (R. 19):

> "The entire statute, from beginning to end, clearly reflects a legislative intent to relieve the railroads from the payment of any Federal taxes, except war taxes, during the time the income from their properties became the property of the Government, and was as to railroads charged with no other burden except the payment of just compensation for the use of the property taken over. The legislation was an indisputable recognition of the constitutional rights of the railroads to receive just compensation, and afforded each of the parties an immediate and complete remedy and opportunity to bring the issue to a permanent end."

And, again, (R. 19):

> "If the statutes governing the subject imposed upon the Government the legal obligation to pay during the period of Federal control the taxes, other than war taxes, assessed against the plaintiff's income for that period, or assessed upon the revenues or any part thereof derived from operation, it would seem in reason and authority, the liability does not cease because the extent of the obligation was not fixed until after the period of control expired. It is no less a legal obligation though delayed in its discharge."

It is submitted that the two per cent tax was not *levied* against appellees, and this being so, whether or not it was *levied* against the Government is of no concern. If the normal tax was *not levied* against appellees' just compensation, it was unlawful to compel its payment by appellees.

It will be borne in mind that when Congress enacted the quoted provisions of section 1 of the Federal Control Act it was not dealing primarily with the *subject of taxation.* Taxes entered into the situation as a mere incident. The important question to be legislated upon was the *just compensation* guaranteed by the Constitution for a taking "under a right in the nature of eminent domain." Section 1 *primarily* deals with such just compensation. In providing the basis for such compensation, what it should include, and *how it should not be diminished,* the section requires that every such *compensation agreement* shall provide that all taxes other than war taxes, on the revenues derived from operation shall be paid from such operating revenues which were to belong solely to the Government,—thereby evidencing the clear intent that the

just compensation to the carriers should not be diminished by the normal two per cent or any other tax except the war tax specifically provided for.

The fact that appellees could not enter into the standard form of contract does not place them in a situation as to just compensation different from that of the carriers which made such contracts. Even in cases where negotiations were necessary, as with appellees, the law provided that contracts should be made, and a contract was finally made with appellees on July 1, 1921. The law provided that "every such contract" should contain the provisions as to taxes, and furthermore, the contract finally made with appellees adopted the provisions of the standard contract as to taxes, (Government's brief, bottom p. 15) and appellees became entitled under the law and under the contract to receive its compensation undiminished by the normal two per cent tax, in the same manner as carriers entering into the standard contracts and receiving their compensation regularly and promptly while Federal control continued.

II.

THE GOVERNMENT'S CONTENTIONS

(*a*) *As to the Law.*

The entire argument of the Government centers upon the use of the words, "assessed for the period of Federal control." To properly understand those words, the situation confronting Congress must be weighed. The obligation to pay just compensation was recognized. Congress had provided an adequate and fair method of arriving at such just compensation, both for carriers entering into the standard con-

tract, and those compelled to negotiate. Congress had the right to assume that the administrative branch of the Government would do its duty and carry out the provisions of the Act. It did not for a moment contemplate that Federal control after being in existence for more than two years would terminate before appellees would receive their just compensation! (As to which party was at fault in appellees' failure to receive their just compensation is best illustrated by the fact that appellees *ultimately* received it.) Congress had a right to assume that all carriers would promptly and regularly be paid while Federal control existed, and it was upon this assumption that the words "assessed for the period of Federal control" were used, and must be construed. Even were this not true, the attempted interpretation by Government counsel of the words, is erroneous: In prohibiting the diminution of just compensation, Congress was dealing with several kinds and classes of taxes—some of which were assessed for stated periods, others upon stated things or values. Naturally, with reference to taxes for stated periods, such as yearly licenses, franchise taxes, real estate and personal property taxes, the Government, in fairness, should not be required to assume or pay beyond the actual period of Federal control; but with reference to taxes assessed upon stated things, such as net operating revenues or net income, the intent was clear that if *it accrued or was payable from operations under Federal control*, it did not matter when it was *received*, for the law was plain that the normal tax upon such operating revenue should be paid out of operating receipts, belonging to the Government.

Finally, it is insisted, that the manifest purpose of Congress that just compensation no matter when re-

ceived, should not be burdened with the two per cent normal tax is so apparent when the prime purpose of section 1 is recalled, that to accede to the contention of the Government as to the effect of the words "assessed for the period of Federal control," would defeat the true legislative intent and would tend to penalize appellees because of the Government's failure to promptly provide the just compensation the law intended, and which was ultimately given.

In the Federal Control Act, dealing primarily with just compensation and not taxation, Congress sought to provide compensation fairly and equally to all carriers whose properties were taken over. The Government now concedes that all carriers promptly receiving their just compensation while Federal control existed, practically all of them, likewise received credit for the very tax now imposed upon appellees. To affirm the imposition of such a tax upon appellees, and upon appellees alone so far as is known, is but to say that Congress intended that all other carriers should receive a more complete, a more adequate and just compensation than these appellees! To state such a proposition is to answer it—it is as illogical as it is unreasonable; and, yet, if the Government's construction of the words "assessed for the period of Federal control" be accepted, there is no escape from such a discriminatory result.

(b.) As To Equitable Considerations.

Much is said by Government counsel as to the lack of equitable consideration in appellees behalf.

Appellees have at no time sought equitable relief or urged equitable considerations. Appellees believe

that the law will afford ample relief. The same argument now advanced by the Government that (Brief 13) "the delay in agreeing upon and paying the compensation to the appellees * * * presents no equitable consideration to justify ignoring the contract," was advanced below and the Court ruled that it was irrelevant to the inquiry. (R. 18.) Why such contention is so persistently made is not readily understood, unless there is something akin to guilty conscience involved because of depriving appellees of the use of their just compensation for several years.

If, however, equities should be considered, appellees insist that in equity as well as in law the judgment should be affirmed, because otherwise insofar as the record shows, and insofar as counsel for appellees is informed, every railroad in the country, *except appellees,* will have received the just compensation provided by Congress, *undiminished by the imposition and collection of the two per cent normal tax!*

To hold that such was the intent of Congress would create a situation unparalleled in American legislative history—and, yet, such is the Government's sole contention!

What counsel for the Government is really driving at here, as below, is to hope that by showing a supposed lack of equity in appellees' position, it would necessarily follow that there is much equity in the position of the Government!! Equitable considerations in favor of the Government were not apparent to the Court below. (R. 18.)

Much use is attempted of the fact that appellees in good faith applied to the Commissioner of Internal Revenue for a ruling as to the rate of tax to be paid and the further fact that the Commissioner held that

the payment of $1,570,000 to appellees in 1921 constituted income "received" in 1921, and taxable as such. That the rate of tax in 1921 was ten per cent was a matter beyond the control of appellees. The same ten per cent rate was applicable in 1919 and 1920, although in 1918 the rate was twelve per cent. Confessing, that the compensation finally allowed was compensation for the use of appellees' properties in 1918, 1919 and 1920, and, should have been paid in those years, the Government contends that had such compensation been pro-rated and allocated to the several years, appellees, *perhaps*, would have paid equal, if not higher taxes.

There is nothing, however, in the record to justify such a wild assumption. Indeed, the converse is more probable, because, it will be recalled, the reason the Government declined to compensate appellees in due season was upon the insistence that the "betterments" and "improvements" made by it, overbalanced the thought of compensation. Inasmuch as a great many of these betterments and improvements were made in 1918, the only twelve per cent tax year, it is doubtful that little, if any, compensation would have been paid for such year under any circumstances. Indeed, appellees do not even at this late day know what, if any, compensation was allowed for the year 1918. And this brings us to the truth of the "vigorous contest," so often referred to in the Government's brief: The Railroad Administration failed in its obligation under the law and under its contract to hold appellees harmless from the collection of the normal two per cent tax, and appellees then requested of the Commissioner a ruling as to the rate of tax to be paid. Appellees knew that practically every railroad in the country had been reimbursed for the two per cent tax upon their

just compensation, and they believed that the law afforded them the same right. The Commissioner held that although the law provided that the two per cent tax should be paid by the Railroad Administration, if the Railroad Administration would not assume the obligation thus imposed, *appellees must do so.* The Commissioner furthermore held that the amount of compensation received in 1921 was income for 1918, 1919 and 1920, and the portion attributed to each year must be returned for taxation. Inasmuch as appellees had received the entire sum as a lump sum settlement of just compensation for all three years and had no way of allocating any portion to any one year, their "vigorous protest," consisted of a request of the Commissioner to tell them how to act in accordance with his ruling. The result was that the Commissioner reversed himself and held that although the sum received in settlement was just compensation for 1918, 1919 and 1920, inasmuch as it was received in 1921, it should be returned as income for 1921; and, appellees, *under protest,* so returned it. (The full text of both rulings of the Commissioner is set out in the appendix.)

Whether returning the entire sum in 1921, resulted in a higher or lower tax for appellees is not ascertainable. In the first place, as has been seen, if appellees had been promptly paid during Federal control, it is improbable that they would have received any compensation for 1918, the only twelve per cent year, because of the claim of betterments and improvements; and, then, it is clear that by throwing the entire three years' income into a single year the amount of the tax would be appreciably higher, *since only one year's credits and deductions could be claimed against three years' income.*

III.

THE DIRECTOR GENERAL OF RAILROADS, IN FINAL SETTLEMENT WITH APPELLEES, EXPRESSLY AGREED TO PAY THE NORMAL TWO PER CENT TAX.

The final settlement agreement between appellees and the Director General of Railroads in no way satisfied or cancelled the statutory obligation binding the administrative officers of the Government to relieve appellees of the payment of the two per cent normal tax. Indeed, the final settlement agreement recognized the obligation resting upon the Director General and specifically bound him to indemnify and hold harmless appellees from the imposition and collection of the tax.

Tax returns covering operations of the preceding year are due to be filed in March of each year. When the settlement was made on July 1, 1921, appellees next tax return was due in March, 1922. Appellees did not know what other income would be received for the six remaining months of 1921 or what deductions they might be entitled to. At the time, therefore, settlement was made in July, 1921, the amount of the two percent tax upon the compensation received could not be determined, agreed upon or settled with the Director General, because such compensation was subject to be added to or reduced by the other operations of appellees.

Section 3 of the settlement agreement therefore contained the following provision:

> "3. This settlement does not include the obligation of the Director General assumed in paragraphs (i) and (j) of Section 4 of said standard contract to save the Company harmless as to claims, if any, of third persons, OR THE OBLI-

GATIONS OF THE DIRECTOR GENERAL IN RESPECT TO THE PAYMENT OF TAXES UNDER SECTION 6 OF THE CONTRACT." (R. 6.) (Italics ours.)

Annexed as exhibits to the petition are paragraphs (i) and (j) of Section 4 referred to (R. 7) and particularly Section 6 of the standard contract (R. 8). Paragraph (c) of Section 6, provides that the Director General shall not only save appellees harmless from all taxes lawfully assessed under federal or other governmental authority, except war taxes, but further provides that the Director General shall pay and save appellees harmless from the expense of all suits respecting the classes of taxes payable by him; and paragraph (b) of Section 6 provides that if any taxes properly chargeable to the Director General have been or shall be paid by appellees, they shall be duly reimbursed therefor.

The obligation of the Director General to reimburse appellees for the amount of the taxes they have been compelled to pay and the expense of this suit asking reimbursement for the same is, under Section 6, paragraphs (b) and (c), just referred to, too plain for further comment. Paragraph 3 of the final settlement agreement instead of diminishing or cancelling this liability only reserves and accentuates it. Had there been no liability upon the part of the Director General for the payment of the taxes now in dispute, there would have been no reason to make reservation in the final settlement contract either to indemnify or to reimburse appellees in the event they were compelled to pay the taxes. The settlement agreement was made on *July 1, 1921, more than a year after the termination of Federal control,* and at a time when the Director

General had available every defense to his liability for the normal tax as is now urged. Not having raised such defenses, but instead having reaffirmed and reiterated the Government's liability for the tax, it is now too late to deny the obligation. The position of appellees has materially changed, and the Government is in possession of a full release for appellees' just compensation which it would probably not have had had appellees known that the Director General did not intend to fulfill the obligation imposed by law and contract in favor of these appellees, the same as had been assumed for all other carriers. Had there been any doubt at the time of settlement that the Government intended to continue its practice of assuming and paying the two per cent normal tax, the question of just compensation would have been the subject of further negotiation. Not having raised the questions now at issue at the time the settlement was made and at a time when the same were equally available as now, the Government should not be permitted to urge that neither the law nor the contract obligated it to pay the tax, especially since appellees have changed their position relying upon the settlement contract.

IV

UNIFORM ADMINISTRATIVE INTERPRETATION BY THE TREASURY DEPARTMENT AND THE RAILROAD ADMINISTRATION IS THAT THE LAW IMPOSED THE NORMAL TWO PER CENT TAX UPON THE GOVERNMENT.

That Congress intended that the just compensation for the use of railway properties during Federal control should not be diminished by the two per cent nor-

mal tax has been the uniform construction of the Railroad Administration until its ruling in the case at bar.

The Court below found—

IV

> "Under the Federal control act and internal revenue acts of 1916, 1917, and 1918 all railroads operating under Federal control were required to return and pay out of their own funds and bear all Federal corporation taxes save and except the original normal corporation tax of two per cent. It was the custom for each carrier to return and pay the said two per cent normal tax, together with the taxes payable and bearable out of its own funds, upon the receipt of its just compensation, whereupon the United States, through the Director General of Railroads, duly credited the carrier to the extent of the said two per cent normal tax so paid."

Insofar as the record discloses, and insofar as counsel is informed, the Director General has not diminished the just compensation of any carrier, save appellees, by a failure to pay the two per cent normal tax. The General Solicitor of the Railroad Administration at one time told counsel for appellees that there were other carriers in appellees position, but although this dispute has been pending for four years, counsel for appellees has not been otherwise informed of any similar case.

There seems to be some confusion in the minds of Government's counsel as to whether appellees were duly credited with the two per cent tax upon the payment to appellees in January, 1920, of the $250,000 "on account," counsel for the Government insisting that "as Federal control ended February 29, 1920, the two months of Federal control in 1920 constituted one-

sixth of the year," and that, therefore, appellees were reimbursed for only one-sixth of the two per cent tax. (Brief, bottom p. 9, Citing Record p. 14.)

A reference to the record page 14, Finding IX, does not bear out the Government's contention. What happened was that appellees maintained a "trust account" for the Railroad Administration. When appellees accounted for taxation the $250,000 payment, they immediately credited themselves with the two per cent tax. (Finding VIII.) The Director General, then *demanded* that five-sixths of the credit be restored. (Finding IX.) That is as far as the Court below found the facts. Whether the dispute is still pending is not disclosed by the record, although the Court below in its opinion holds that the Government paid the two per cent tax upon this $250,000 payment (R. 19, lines 15-18), and the Commissioner of Internal Revenue in his decision of July 14, 1922 (Appendix) held that appellees received full credit for the two per cent tax on the $250,000 payment.

The Commissioner of Internal Revenue, in his decision of July 14, 1922 (Appendix), held, that,

> "It was the intention of Congress that this 2% tax which was not regarded as a war tax should be paid by the Railway Administration."

and that the Director General, in the contracts—

> "obligated himself to account for all Federal income taxes for which the railroad companies were not made responsible by specific provision of law in amendment of the Revenue Act of 1917."

These rulings of the Commissioner of Internal Revenue were made in *July, 1922,* more than two years after the termination of Federal control!

As late as December 3, 1923, the Commissioner of

Internal Revenue reaffirmed this settled and consistent administrative construction of the law: In Ruling II-35-1229. S. T. 433, Internal Revenue Cumulative Bulletin II-2, pp. 290, 292, the following language is used:

> "It will be noted that Section 12 of the Federal Control Act, after providing that the money derived from the operation of the carriers during Federal control shall be regarded as property of the United States, makes provision for the disbursement thereof, and further provides that the taxes imposed by Titles I and II of the Revenue Act of 1917 'shall be paid by the carrier out of its own funds.' This language of Section 12 has been accepted by the officers of the United States Railroad Administration as defining the taxes 'commonly called war taxes' referred to in section 1 of the Federal Control Act. Under this construction of the Federal Control Act, the liability of the railroads for taxes under the Revenue Act of 1917 has been limited to those imposed by Titles I and II of that Act, and those taxes imposed under other titles of that Act are payable, if due at all, from money which, under the Federal Control Act, is designated Federal property.
>
> That the construction placed on the Federal Control Act by the officers of the Railroad Administration was adopted by Congress is apparent from the provisions of section 230 (b) of the Revenue Act of 1918. This provision reads as follows:
>
> 'For the purposes of the Act approved March 21, 1918, entitled "An Act to provide for the operation of transportation systems while under Federal control, for the just compensation of their owners, and for other purposes," five-sixths of the tax imposed by paragraph (1) of subdivision (a) and four-fifths of the tax imposed by paragraph (2) of subdivision (a) shall be treated as

levied by an Act in amendment of Title I of the Revenue Act of 1917.' "

It is respectfully submitted that this uniform and consistent administrative construction by two branches of the Government upon every occasion the question has arisen, so far as is known, is entitled to great, if not, controlling, weight.

V.

THE CROSS-APPEAL. APPELLEES ARE ENTITLED TO RECOVER THE EXPENSE OF THIS LITIGATION.

The cross-appeal is from the refusal of the Court below to allow appellees the reasonable expense of prosecuting the suit, including attorneys' fees. (R. 25.)

The Government maintains that there is no allegation upon the subject except in the prayer in the petition. (Brief 33.) Such a statement is wholly inaccurate.

In paragraph 1, second count of the petition (R. 4), the allegation is made that "the United States further agreed to pay or save the plaintiff harmless from the expense of all suits respecting the classes of taxes payable under the agreement."

In paragraph 2, second count (R. 4) the allegation is made that the appellees called upon the Director General of Railroads to reimburse them for the 2% tax paid, "plus such reasonable sum as the Court might, in its discretion, fix for counsel fees and other expenses in connection with this suit."

In paragraph 3, second count (R. 4), the allegation is made that appellees were justly entitled to recover

the amount of the 2% tax paid "plus such reasonable sum as the Court might, in its discretion, fix for counsel fees and other expenses in connection with this suit."

There were only *three* paragraphs in the second count.

Appellees' requested finding of fact VIII in the Court below asked that the Court find that a reasonable sum for such attorneys' fees and expenses up to the date of the judgment below was $5,000.00 and the requested conclusion of law was that the Court should include in its judgment such sum. The Court, however, omitted such a finding and failed to include such an amount or any other amount in its judgment, although it was stated in the opinion that the contract "even extended the obligation to the payment of expenses by the defendant in the event of litigation respecting the same, (the tax involved)." (R. 21.)

The claim for expenses is based upon the following language in Section 6 (c) of the standard contract (R. 9):

> "The Director General shall pay or save the Company harmless from the expense of all suits respecting the classes of taxes payable by him under this agreement."

Obviously, if the tax involved comes within "the classes of taxes" payable by the Director General under the law and under the contract, it needs no argument to demonstrate that this is a suit respecting such taxes.

The Government's sole thought upon the cross appeal is that "there were many cases in which the Director General questioned the validity of taxes and

required the carrier to litigate the same," and that "the contract was intended to save the carriers harmless from the expense of such litigation."

Counsel concedes the correctness of each of these statements, but it is difficult to understand how such statements can make the present controversy any the less a "suit respecting the classes of taxes" payable by the Director General.

"Classes of taxes payable by him" is very broad language, and to concede that one class of tax comes within it in no way implies that another class is excluded. The plural, "classes," does not permit of such construction. Thus it is that if the tax involved is chargeable to the United States, the expense of this litigation necessarily follows.

CONCLUSION

Laws levying taxes must be strictly construed, and,

> "If the words are doubtful, the doubt must be resolved against the Government and in favor of the taxpayer." (United States v. Merriam, 263 U. S. 179, 188, Citing Gould v. Gould, 245 U. S. 151.)

We submit that there is no doubt as to the clear intent of Congress that the just compensation of carriers under Federal control was to come to them undiminished by the normal two per cent tax no matter at what period of time such just compensation might have been received; but that if a doubt arises appellees are entitled to the benefit of the above quoted rule of construction.

We submit that if ever there was doubt, the same

has been removed by consistent administrative interpretation whenever the question has arisen, and that this administrative construction is entitled to great and controlling weight.

We submit that although negotiations were actively engaged in from the beginning of Federal control in January, 1918, and were actively carried on all through 1918, 1919, 1920 and 1921, the Government refused to give appellees their just compensation until July 1, 1921.

We submit that the head upon which the fault must lie for thus depriving appellees of the use of its just compensation for such a length of time is best shown by the fact that ultimately appellees were paid $1,570,000, in addition to the $250,000 "on account" payment.

We submit that the only real or substantial question in the case is—

> Whether Congress intended that the just compensation of all carriers should be computed upon the same basis; or whether because a carrier without its fault is deprived of its just compensation for a period of time extending beyond the duration of Federal control, the law intended that it should be discriminated against and penalized to the extent of having its compensation diminished by the payment of a tax which the Government uniformly assumed or paid for all carriers *promptly* receiving their just compensation?

It is submitted that the judgment against the United States should be affirmed, and that the judgment insofar as it omitted a reasonable allowance for the expense of the suit should be remanded to the Court of

Claims with instructions to ascertain such reasonable expense and to enter judgment therefor.

Respectfully submitted,

HARVEY D. JACOB,
Attorney for Appellees.

FRANK M. SWACKER,
Of Counsel.
February, 1926.

APPENDIX

TREASURY DEPARTMENT

WASHINGTON

Office of
Commissioner of Internal Revenue.

July 14, 1922.

Address Reply to
Commissioner of Internal Revenue
and Refer to

IT:E:RR
FMH

Mr. Harvey D. Jacob,
Woodward Building,
Washington, D. C.

Sir:

Reference is made to your letter of March 13, 1922, making inquiry in behalf of The Pittsburgh and West Virginia Railway Company relative to the rate of tax applicable to an amount received from the Government in 1921 as final settlement of compensation allowed as rental during the period of Federal control.

It is stated that when taken over by the Railway Administration, The Pittsburgh and West Virginia Railway Company was a reorganization of the old Wabash-Pittsburgh Terminal Railway Company, such reorganization having been effected April 1, 1917. Consequently, this company came within that class of carriers whose expenditures for additions, improvements or equipment were not fully reflected in the operating railway income for the three-year period prior to June 30, 1917, and under the Federal Control Act of March 21, 1918, it became necessary for the President, acting through the Railway Administration, to make an agreement with the Pittsburgh and West Virginia Railway Company for just compensation due the railroad while under Federal control. Because of the wide divergency of opinion between the company and the

Director General throughout the negotiations in 1918, 1919 and 1920 as to what the compensation should be, no agreement was reached until 1921, at which time $1,570,000 was paid the company in addition to $250,000 which was paid in January, 1920, on account.

It is stated further that in reporting the amount received on account of compensation in 1920 the company, following the established custom, paid the full rate of corporation income tax under Section 230 of the Revenue Act of 1918 and Section 1 of the Federal Control Act of March 21, 1918, and subsequently was reimbursed by the Director General, in the amount paid representing the 2 per cent tax, which, under the provisions of law above referred to, was required to be paid out of revenues derived from railway operations while under Federal control.

The Federal Control Act of March 21, 1918, contains the following provision:

> "Every such agreement shall provide that any Federal taxes under the Act of October 3, 1917, or Acts in addition thereto or in amendment thereof, commonly called 'war taxes' assessed for the period of Federal control beginning January 1, 1918, or any part of such period, shall be paid by the carrier out of its own funds, or shall be charged against or deducted from the just compensation; that other taxes assessed under Federal or other governmental authority for the period of Federal control or any part thereof, either on the property used under such Federal control or on the right to operate as a carrier, or on the revenues or any part thereof derived from operation * * * shall be paid out of the revenues derived from railway operations while under Federal control. * * *"

At the time of the passage of the Federal Control Act the 2% tax imposed on the net income of corporations under the Revenue Act of 1916 was in effect and it was the intention of Congress that this 2% tax

which was not regarded as a war tax should be paid by the Railway Administration, but that the additional taxes imposed by the Act of October 3, 1917, or Acts in addition thereto or in amendment thereof should be paid by the carriers from their own funds. When the rates of taxation against corporations were increased in the Revenue Act of 1918, the following provision was inserted therein:

> "Section 230 (b). For the purposes of the Act approved March 21, 1918, entitled 'An Act to provide for the operation of transportation systems while under Federal Control, for the just compensation of their owners, and for other purposes,' five-sixth of the tax imposed by paragraph (1) of subdivision (a) and four-fifths of the tax imposed by paragraph (2) of subdivision (a) shall be treated as levied by an Act in amendment of Title I of the Revenue Act of 1917."

In the standard contract made with the various carriers the Director General of Railroads obligated himself to account for all Federal income taxes for which the railroad companies were not made responsible by specific provision of law in amendment of the Revenue Act of 1917, whether such taxes were attributable to revenue from operations or from other income. He was, therefore, accountable for one-sixth of the income tax of railroads under Federal control for 1918, and for one-fifth of such tax for subsequent years on income from all sources, whether or not derived from railway operations. To facilitate the handling of the accounts, the various carriers during the period of Federal control paid the full income tax for each year and were thereupon credited by the Director General with the amount for which he was accountable. This course was pursued in the instant case on the $250,000 payment which was made to the railroad in 1920. It could not be followed, however, when the final payment was made in 1921 as the railroads had been returned to their private owners.

Section 230 (a) of the Revenue Act of 1918 reads as follows:

> "That in lieu of the taxes imposed by Section 10 of the Revenue Act of 1916, as amended by the Revenue Act of 1917, and by Section 4 of the Revenue Act of 1917, there shall be levied, collected and paid for each taxable year upon the net income of every corporation a tax at the following rates:
>
> (1) For the calendar year 1918, 12 per centum of the amount of the net income in excess of the credits provided in Section 236; and
>
> (2) For each calendar year thereafter, 10 per centum of such excess amount."

Inquiry is made as to whether or not the two per cent should be treated as a deduction by the company in reporting the amount received as final settlement of compensation in 1921.

Section 230 (a) of the Revenue Act of 1918, levies a tax of 12 per cent for the year 1918 and 10 per cent for each calendar year thereafter on the net income of every corporation. Railway corporations, while under Federal control, are therefore subject to these rates unless this provision is amended by some other section of the Act. Section 230 (b), the only other section applicable, cannot be construed as amendatory of the levying section. This section merely provides that for the purposes of the Federal Control Act, five-sixths of the tax imposed for the year 1918 and four-fifths for each calendar year thereater shall be treated as levied by an Act in amendment of Title I of the Revenue Act of 1917 and, therefore, payable by the carriers from their own funds. Instead of reducing the rate of taxation of railroads under Federal control, it specifically recognizes the applicability thereto of the rates set forth in the preceding paragraph of the Act and classifies the tax for the purposes of the Federal Control Act which designates the funds from

which the tax is to be paid. Any payment, therefore, of part of the tax by the Railroad Administration is in satisfaction of an obligation or liability of the carrier. If the Railroad Administration after the expiration of Federal control, no longer pays part of that obligation imposed upon the railroads by Section 230 (a) of the Revenue Act of 1918, the railroads themselves are necessarily liable. The Pittsburgh and West Virginia Railroad Company is, therefore, subject to the normal income tax of 12 per cent on that portion of the payment received in 1921 representing compensation for the year 1918 and 10 per cent on the remainder.

Respectfully,
(Signed) D. H. Blair,
Commissioner.

TREASURY DEPARTMENT
WASHINGTON

Office of
Commissioner of Internal Revenue

Address Reply to
Commissioner of Internal Revenue
and Refer to

September 8, 1922.

IT:E:RR
VHW

Mr. Harvey D. Jacob,
Woodward Building,
Washington, D. C.

Sir:

Reference is made to your letter of July 20, 1922, with respect to the rate of tax to be returned by the Pittsburgh and West Virginia Railway Company.

You quote from the letter of this Bureau, dated July 14, 1922, by which you were informed that this Company is subject to normal tax at the rate of 12% on that portion of a payment received in 1921 from the

Railroad Administration which represented compensation for the year 1918 and to normal tax at the rate of 10% on the remainder, and state that this Bureau overlooked certain important facts in making this decision.

The facts said to have been overlooked are: that the Pittsburgh and West Virginia Railway was a company whose earnings for the years previous to the time when it was taken over by the Government could not be accurately determined because of its recent organization, and that it was, therefore, one of the companies coming under Section 3 of the Federal Control Act, which was forced to negotiate with the Railroad Administration in order to establish the amount of the just compensation payable to it while under Federal control, and that it was impossible to determine what, if any, earnings the company realized during the period of Federal control; that while under Federal control the Railway Company negotiated with the Railroad Administration in order to determine the compensation, if any, to which it was entitled; that the company insisted that it had realized net earnings and was entitled to compensation, while the Railroad Administration insisted that there was no net earnings and that consequently the company was not entitled to compensation, and declined to grant any compensation for the years 1918 and 1919; that during 1920 an agreement was reached between the parties whereby the Railway Company was paid $250,000 on account, and that in 1921 the company was awarded further compensation amounting to $1,570,000; and that this latter amount was paid in 1921 and was in full compromise and settlement of all claims for compensation during the period of full control.

You state that there was no way in which the income for the year 1918 could be accrued as at that time and for a long time thereafter the Railroad Company did not and could not know that it would receive any compensation whatever for 1918, and that the insistence of the Railroad Administration that the company was entitled to no compensation whatever made receipt of compensation for 1918 a very remote contingency.

Based upon the foregoing statement of facts you contend that the entire amount of the compromise settlement should be subject to tax at not more than 10%, representing the rate in force at the time it was received, and that no part of such amount should be taxed at the 1918 rate of 12%. This contention is made without waiving your claim that the true rate of tax is 8%.

In reply you are advised that upon a further consideration of this matter in connection with the facts stated in your present letter, the Bureau modifies the last paragraph of its letter to you, dated July 14, 1922, and now holds that the amount received in 1921 by the Pittsburgh and West Virginia Railway Company from the Railroad Administration is income for that year.

Respectfully,

(Signed) D. H. BLAIR,
Commissioner.